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To The Commission

PETITION FOR RULEMAKING

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SUMMARY

Council Free Communications, Inc. ("Council Free") urges the Commission to amend Part 1 of its Rules to include a personal net worth limitation for competitive bidding small business preference eligibility. The Commission's designated entity program was designed to secure opportunities to participate in the provision of spectrum-based services for smaller businesses and businesses owned by members of minority groups and women, consistent with the intent of Congress to promote economic opportunity where it might not otherwise exist. When it enacted Section 309(j) of the Communications Act to give the Commission auction authority, Congress was concerned that a system of competitive bidding would tend to favor only those with deep pockets. To address this concern, the Commission has undertaken to see that the designated entity benefits to be offered in competitive bidding are reserved for those that legitimately need government assistance to join the information economy.

Today, however, high net worth individuals have recognized that the Commission does not count personal wealth in assessing the size of a business that applies for auction-related *bidding credits or set-asides*. If a high net worth individual does not have his or her wealth tied to ownership of other businesses — or if such other businesses have few or no gross revenues — the Commission's approach leaves the door open for that individual to receive the government benefits meant for disadvantaged enterprises. This type of flaw threatens the very availability of competitive bidding preferences for true designated entities. In 1995, Congress eliminated the availability of tax certificates for members of minority groups in part because the program had ceased to serve the ends envisioned by Congress. The Commission must ensure that its designated entity program is administered in a manner consistent with the goals of Congress to avoid a similar result here.

To address this problem, the Commission should look to the Small Business Administration's ("SBA's") small disadvantaged business program, where a concern is not eligible to participate if any attributable investor in the applicant has personal net worth valued at \$750,000 or more. Specifically, in addition to applying such other limitations as it uses to establish small business preference eligibility (*e.g.*, gross revenues tests), the Commission should provide that no competitive bidding preference made available based on business size shall be awarded to an applicant if the personal net worth of any attributable individual investor in the applicant exceeds the SBA's cap. This limitation should be applied by the Commission only to an individual with both a controlling interest in the applicant under the Commission's rules *and* an appreciable equity interest in the applicant. The limitation also should be applied to affiliates of a controlling interest holder with an appreciable equity stake.

Under this approach, officers and directors with no meaningful equity stake in an applicant will not be affected. Similarly, wealthy individuals without a controlling interest in an applicant will still be free to invest. It will be wealthy individuals masquerading as designated entities who will – and should – be denied government assistance. Establishing and enforcing this rule will help to ensure that the benefits to be offered in the competitive bidding process will be reserved for those that need government assistance to participate in the provision of spectrum-based services. It will also help to preserve the designated entity program by adhering strictly to the intent of Congress, not promoting the interests of deep pockets. For these reasons, and for the reasons set forth more fully in this *Petition*, *Council Tree* urges the Commission to amend Part I of its Rules to include a personal net worth limitation for competitive bidding small business preference eligibility.

In the Matter of)
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 COUNCIL TREE COMMUNICATIONS, INC) RM-__ ____
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 Petition for Amendment of Part 1 of the)
 Commission's Rules to Include a Personal Net)
 Worth Limitation for Competitive Bidding)
 Small Business Preference Eligibility)

 To The Commission

Council Tree Communications, Inc. ("Council Tree"), pursuant to Section 1.401 of the Commission's Rules, 47 C.F.R. § 1.401, hereby petitions the Commission to amend Part 1 of its Rules to include a personal net worth limitation for competitive bidding small business preference eligibility.

Council Tree is an investment company organized to identify and develop communications industry investment opportunities for the benefit of businesses owned by members of minority groups and women, recognizing that business success can accompany the meaningful diversification of communications facilities ownership. As part of this work, Council Tree has long been an active supporter of responsibly-managed government efforts to encourage the participation of new entrants in the communications industry. In 2003, Council Tree president Steve C. Hillard was appointed to the Commission's Advisory Committee on Diversity in the Digital Age, and he serves as chairman of the Committee's Transactional Transparency & Related Outreach subcommittee.

Among other groups, Council Fire works with Alaska Native Regional Corporations organized by Congress under the terms of the Alaska Native Claims Settlement Act ("ANCSA").¹ Enacted in 1971, ANCSA represents a novel approach to U.S.-Native American relations. Rather than create a system of reservations, Congress directed that thirteen regional corporations be established, that Alaska Natives be enrolled to these corporations, and that the corporations issue to their members shares that could not be sold or otherwise pledged. Thus, Alaska Natives were ushered into the world of corporate shareholder status. They became the owners of corporations that hold the collective results of their settlements with the federal government. In turn, the corporations are assigned the challenge of earning profits for those shareholders and attending to the shareholders' real social and economic needs.

Cognizant of their special status, the nature of their shareholder bases, and the broad mission bestowed on them by Congress, some Alaska Native Corporations have moved in recent years to diversify the economic base from which they serve their shareholders by entering the telecommunications field. However, telecommunications operations are highly capital intensive, which makes competing for valuable federal licenses against entrenched telecommunications providers especially difficult. Those providers frequently have markedly greater resources than less established enterprises, and they are able to link those resources with their industry expertise to dominate a particular market or service.

Congress recognized this when, as part of the Omnibus Budget Reconciliation Act of 1993, it directed the Commission to consider a variety of measures to ensure that small businesses, rural telephone companies, and businesses owned by members of minority groups

¹ See 43 U.S.C. § 1601 *et seq.* (2004).

and women are given the opportunity to participate in the provision of spectrum-based services when licenses are to be awarded through competitive bidding. The Commission, in turn, developed policies to help ensure that these designated entities have the chance to enter the wireless industry for the first time through license ownership. This is an important opportunity for the intended beneficiaries as they undertake to become part of this complex field.

Recently, however, it has become increasingly clear that many disadvantaged businesses will be crowded out of meaningful participation in the Commission's designated entity program by those who need no government assistance to join the information economy. High net worth individuals have recognized that the Commission does not count personal wealth in assessing the size of a business that applies for auction-related bidding credits or set-asides. These individuals—many of whom made fortunes in the wireless industry—parlay their assets and contacts into sweetheart deals with key strategic investors. For their part, investors prefer to work only with associates and former colleagues, particularly if these wealthy individuals qualify for the same auction-related preferences as persons with little or no experience in the provision of wireless services. As a result, legitimate designated entities are increasingly excluded from critical strategic relationships. Without the backing and expertise of experienced wireless service providers, would-be new entrants cannot meaningfully enter this complex business at all.

To address this growing problem, the Commission should limit the availability of scarce federal assistance to those facing the barriers that the designated entity rules were meant to overcome. The Small Business Administration ("SBA") excludes individuals with high personal net worth from its small business programs, and the Commission itself created personal net worth limitations in 1994 as part of its original broadband personal communications service ("PCS") rules. The Commission abandoned those limitations later that year after wealthy

individuals complained that the rule would prevent them from investing in designated entities. Now, however, the same wealthy individuals may qualify as designated entities *themselves* under the Commission's standards for small business eligibility. That cannot have been what Congress intended. For these reasons, and for the reasons set forth more fully below, Council Tree urges the Commission to amend Part I of its Rules, as set forth in ATTACHMENT I hereto, to include a *personal net worth limitation for competitive bidding small business preference eligibility*.

II. THE COMMISSION SHOULD ESTABLISH A PERSONAL NET WORTH LIMITATION FOR COMPETITIVE BIDDING SMALL BUSINESS PREFERENCE ELIGIBILITY

A. The Designated Entity Program was Created for Those Who Need the Government's Help to Participate in the Provision of Spectrum-Based Services

The designated entity program was created to secure opportunities to participate in the provision of spectrum-based services for those who would otherwise be excluded under a system of competitive bidding. The need for this approach was apparent even before the advent of the Commission's auctions authority. According to a 1993 House Budget Committee Report on the legislation that became the Omnibus Budget Reconciliation Act of 1993,

The Committee is concerned that, unless the Commission is sensitive to the need to maintain opportunities for small businesses, competitive bidding could result in a significant increase in concentration in the telecommunications industries.²

The Report explained that

One of the primary criticisms of utilizing competitive bidding to issue licenses is that the process could inadvertently have the effect of favoring only those with "deep pockets", and therefore have the wherewithal to participate in the bidding process.³

² H.R. Rep. No. 103-111, at 254 (1993).

³ *Id.* at 255.

On that basis, as part of the grant of auction authority under Section 309(j), the Commission was directed to promote “economic opportunity . . . by disseminating licenses among a wide variety of applicants, including small businesses, rural telephone companies, and businesses owned by members of minority groups and women,”⁴ and to “ensure that small businesses, rural telephone companies, and businesses owned by members of minority groups and women are given the opportunity to participate in the provision of spectrum-based services.”⁵

In the service of these directives, the Commission in 1994 considered a series of initiatives calculated to improve the ability of designated entities to become Commission licensees through competitive bidding. According to the Commission, the principle obstacle to be addressed in this regard was the inability of many designated entities to attract the financing needed to win licenses in competitive bidding and to provide service thereafter.⁶ This problem was particularly acute in the case of a capital-intensive service such as broadband PCS

because broadband PCS licenses in many cases are expected to be auctioned for large sums of money in the competitive bidding process, and because build-out costs are likely to be high, it is necessary to do more to ensure that designated entities have the opportunity to participate in broadband PCS than is necessary in other, less costly spectrum-based services. In our view, these steps and the others we adopt are required to fulfill Congress’s mandate that designated entities have the opportunity to participate in the provision of PCS.⁷

⁴ 47 U.S.C. § 309(j)(3)(B) (2004).

⁵ *Id.*, § 309(j)(4)(D).

⁶ See, e.g., Implementation of Section 309(j) of the Communications Act—Competitive Bidding, Fifth Report and Order, 9 FCC Rcd 5532, 5572-73 (1994) (“Competitive Bidding Fifth Report and Order”).

Id. at 5572-73.

to promote capital formation for designated entity competitive bidding and system construction in the case of broadband PCS, the Commission resolved (1) to set aside two broadband PCS spectrum blocks for bidding by smaller businesses only, (2) to offer bidding credits to smaller businesses and businesses owned by members of minority groups and women, (3) to permit designated entities to pay for certain licenses in installments, (4) to offer a tax certificate for businesses owned by members of minority groups and women, and (5) to reduce the upfront payment required for designated entities to bid for licenses in the set-aside spectrum blocks.⁸

In addition to improving the ability of designated entities to attract capital, a goal of the designated entity program was to help new entrants draw on the experience of established firms and managers as a way to increase their odds of success. The Commission explained in the course of refining its broadband PCS designated entity provisions in 1994 that its new attribution rules would

(1) promote investment in designated entities generally, (2) attract and promote skilled management for applicants, and (3) encourage involvement by existing firms that have valuable management skills and resources to contribute to the success of applicants.⁹

The Commission also expressly permitted designated entities to enter into management or joint marketing agreements with experienced firms -- even if the firms had invested in the smaller business -- without contravening the attribution thresholds in its entrepreneurs' block rules.¹⁰

⁸ See id. at 5580.

⁹ Implementation of Section 309(j) of the Communications Act -- Competitive Bidding, Fifth Memorandum Opinion and Order, 10 FCC Rcd 403, 441 (1994) ("Competitive Bidding Fifth MO&O").

¹⁰ See Implementation of Sections 3(n) and 332 of the Communications Act, Fourth Report and Order, 9 FCC Rcd 7123, 7124 (1994) ("NIRS Fourth Report and Order") ("We expect that investor manager agreements are one of the many alternatives available to designated

According to the Commission, “[i]nvestments by cellular providers in [] designated entities should increase the entities’ chances for success in the auctions and later in service competition by providing access to capital and valuable industry experience.”¹¹

In crafting these provisions, the Commission undertook to see that the benefits to be offered in the competitive bidding process would be reserved for those that needed government assistance to participate in the provision of spectrum-based services. Thus, excluded from eligibility for small business benefits were large firms and very wealthy individuals. In the case of the latter, the Commission established that a business would not be eligible for closed bidding (*i.e.*, the set-aside entrepreneurs’ blocks) if any attributable individual investor in the applicant had personal net worth valued at \$100 million or more.¹² Further, a business would not be eligible for small business treatment if any attributable individual investor in the applicant had personal net worth valued at \$40 million or more.¹³ The idea, according to the Commission, was to “prevent a very wealthy individual from leveraging his or her personal assets to allow the

entities [] This does not mean, however, that these management agreements will be deemed “attributable” for purposes of the revenue thresholds in the entrepreneur’s blocks”), Competitive Bidding Fifth Report and Order, 9 FCC Red at 5601 n.135 (“So long as the applicant remains under the *de jure* and *de facto* control of the control group, we shall not bar passive investors from entering into management agreements with applicants”).

¹¹ Amendment of the Commission’s Rules to Establish New Personal Communications Services Memorandum Opinion and Order, 9 FCC Red 4957, 5008-09 (1994) (“Broadband PCS Reconsideration Order”).

¹² Competitive Bidding Fifth Report and Order, 9 FCC Red at 5585, 5600.

¹³ Id. at 5608-09.

applicant to circumvent the [applicable] size limitations”¹⁴ Such a result, the Commission explained, would not be consistent with the intent of Congress.¹⁵

The point of the Commission’s designated entity program, therefore, was to secure opportunities to participate in the provision of spectrum-based services for smaller businesses and businesses owned by members of minority groups and women, consistent with the intent of Congress to promote economic opportunity where it might not otherwise exist. In fulfilling that mission, the Commission recognized that the lack of access to capital frequently limits the ability of smaller businesses to compete with established telecommunications companies,¹⁶ and it undertook to develop “preferences [that] will allow designated entities to overcome barriers that have impeded these groups’ participation in the telecommunications arena”¹⁷ In this way, the Commission worked to heed the warning of Congress that the competitive bidding process should not “inadvertently have the effect of favoring only those with ‘deep pockets’”¹⁸

¹⁴ Id. at 5586.

¹⁵ See id. at 5606 (“[I]t is our intent, and the intent of Congress, that women, minorities and small businesses be given an opportunity to participate in broadband PCS services, not merely as fronts for other entities, but as active entrepreneurs.”)

¹⁶ See Implementation of Section 309(j) of the Communications Act – Competitive Bidding, Second Report and Order, 9 FCC Rcd 2348, 2389-90 (1994).

¹⁷ Id. at 2389.

¹⁸ H.R. Rep. No. 103-111 at 255.

B. In the Absence of a Personal Net Worth Limitation, Wealthy Individuals May Qualify for Government Help

Now, however, the Commission's competitive bidding rules could have just such an effect. In 1994, the Commission eliminated the personal net worth limitations for broadband PCS entrepreneurs' block and small business eligibility.¹⁹ Separately, in 2000, the Commission adopted the so-called "controlling interest" standard as its general attribution rule in this context.²⁰ Under the "controlling interest" standard, the Commission attributes to the applicant the gross revenues of those individuals and entities with *de jure* and *de facto* control over the enterprise,²¹ but it does not require any such controlling interest individual or entity to hold a particular level of equity in the applicant as part of the control test.²² According to the Commission, "the *de jure* and *de facto* concepts of control, together with the application of our affiliation rules, will effectively prevent larger firms from illegitimately seeking status as small businesses."²³

In the absence of a personal net worth limitation, however, little prevents *wealthy individuals* from seeking status as small businesses. When the Commission eliminated the personal net worth tests for broadband PCS, it expressed the view that "the affiliation rules make

¹⁹ See Competitive Bidding, Fifth MO&O, 10 FCC Red at 421.

²⁰ See Amendment of Part 1 of the Commission's Rules — Competitive Bidding Procedures, Order on Reconsideration of the Third Report and Order, Fifth Report and Order, and Fourth Further Notice of Proposed Rulemaking, 15 FCC Red 15293, 15323 (2000) ("Part 1 Fifth Report and Order").

²¹ *Id.* at 15324.

²² *Id.* at 15325-26. Cf. 47 C.F.R. § 24.709(b)(1)(v)-(vi) (setting forth the minimum equity requirements for eligibility under the broadband PCS control group attribution scheme).

²³ Part 1 Fifth Report and Order, 15 FCC Red at 15325.

the personal net worth rules largely unnecessary since most wealthy individuals are likely to have their wealth closely tied to ownership of another business.²⁴ The Commission articulated this view again in 2003 when it clarified that the personal net worth of an applicant's officers and directors will not be attributed to the applicant under the controlling interest standard.²⁵ Yet, if a high net worth individual does *not* have his or her wealth tied to ownership of other businesses - or if such other businesses have few or no gross revenues - the Commission's approach leaves the door open for that individual to receive the government benefits meant for disadvantaged enterprises.

For example, an individual with a personal net worth valued at \$25 million may readily form a new, wholly-owned limited liability company ("LLC"), which would have no gross revenues in any of the previous three years by virtue of being newly-created. The Commission does not test the individual's personal net worth, so if the individual had no affiliates, the LLC would qualify for a bidding credit as high as 35 percent under the Commission's Rules.²⁶ In 1994, the Commission explained that a "bidding credit will function as a discount on the bid price a firm will actually have to pay to obtain a license and, thus, will address directly the financing obstacles encountered by these [designated] entities."²⁷ By virtue of the absence of a

²⁴ Competitive Bidding Fifth MO&O, 10 FCC Red at 421.

²⁵ See Amendment of Part I of the Commission's Rules -- Competitive Bidding Procedures, Second Order on Reconsideration of the Third Report and Order and Order on Reconsideration of the Fifth Report and Order, 18 FCC Red 10180, 10185 (2003).

²⁶ See 47 C.F.R. § 1.2110(f)(2)(i) (2004).

²⁷ Competitive Bidding Fifth Report and Order, 9 FCC Red at 5590.

personal net worth limitation, the Commission now extends that discount to a high net worth individual who may experience no financing obstacles at all.

Consider also that a great deal of affluence has been created in the last decade through the use of corporate stock options, which many exercise when leaving a company in connection with a merger or early retirement. The Commission has indicated that an officer or director who leaves a company and forms or works for another is not, by virtue of that fact itself, considered an affiliate of the first.²⁸ Thus, an individual who has made a fortune in the wireless industry, but who is no longer affiliated with his or her former company, may form a new LLC and use his or her contacts to partner with an existing wireless service provider. Due to the lack of a minimum equity requirement for controlling interests, that wireless service provider could provide the bulk of the equity of the venture, provided that the individual retains *de jure* and *de facto* control of the LLC. The wealthy individual, meanwhile, may pledge his or her personal assets to secure financing for any desired capital contribution to the LLC. Faced with the choice between investing in a true new entrant or partnering with a wealthy industry veteran, the wireless company will almost certainly prefer the latter, particularly if the wealthy individual qualifies for the *same* auction-related benefits as those with little or no experience in the provision of wireless services.

In 1994, the Commission established personal net worth limitations for broadband PCS to prevent very wealthy individuals from leveraging their personal assets to allow the applicant to circumvent designated entity size limitations.²⁹ Today, however, that is precisely what the

²⁸ See AirGate Wireless, L.L.C., Assignor, and Cricket Holdings, Inc., Assignee, Memorandum Opinion and Order, 14 FCC Red 11827, 11843 (Com. Wir. Div. 1999).

²⁹ Competitive Bidding Fifth Report and Order, 9 FCC Red at 5586.

Commission's Rules permit. If a high net worth individual does *not* have his or her wealth tied to ownership of other businesses – or if such other businesses have few or no gross revenues – the Commission's current approach leaves the door open for that individual to receive the government benefits meant for disadvantaged enterprises. In the process, legitimate designated entities are forced to compete on the same footing with those who need no government help to enter the information economy. True new entrants also risk losing the opportunity to partner with experienced service providers and managers, who can manufacture their own "designated entity" under the Commission's standards. This cannot have been what Congress intended.

C. Enforcing a Personal Net Worth Limitation Will Help to Preserve the Designated Entity Program

The ability of high net worth individuals to receive government benefits through the operation of the Commission's rules constitutes a material threat to the competitive bidding designated entity program. In 1995, Congress eliminated the availability of tax certificates for members of minority groups³⁰ in part because the program had ceased to serve the ends envisioned by Congress. The Commission must ensure that its designated entity program is administered in a manner consistent with the goals of Congress to avoid a similar result here, and the Commission should act soon.

In December, 2000, the Commission published the results of a series of market entry barrier studies that examined the participation of businesses owned by members of minority groups and women in Commission-regulated businesses. Among other things, one study concluded that the ability of members of minority groups to acquire wireless licenses in the

³⁰ See Self-Employed Health Insurance Act of 1995, Pub. L. No. 104-7, § 2, 109 Stat. 93 (1995) (eliminating the minority tax certificate program).

Commission's spectrum auctions had been enhanced by the availability of post-auction installment payment plans.³¹ According to a second study

It is suggested that a national policy of auctioning spectrum, without remedying discrimination in capital markets, is a national policy of discrimination against minorities and women in the allocation of spectrum licenses. This is because the auctions of the FCC require up-front payments and because spectrum licenses go to the highest bidder. When there is capital market discrimination, minorities will be capital constrained and less likely to qualify for any auction and less likely to win auctions. The data presented suggest that minorities are less likely to win wireless licenses after controlling for relevant variables.³²

And a third study found that the lack of access to capital reported by businesses owned by members of minority groups and women continues to be the dominant barrier to entry to the capital intensive wireless industry for these entities.³³

Since 1995, however, the number of incentives available to designated entities in competitive bidding has been declining. As noted above, Congress eliminated the availability of tax certificates for members of minority groups. For its part, the Commission no longer offers the installment payment financing that so enhanced the ability of members of minority groups to acquire licenses in competitive bidding,³⁴ it no longer permits smaller businesses to qualify for

³¹ See Ernst & Young, LLP, FCC Econometric Analysis of Potential Discrimination Utilization Ratios for Minority- and Women-Owned Companies in FCC Wireless Spectrum Auctions 4, 11, 13 (Dec. 5, 2000) (available at www.fcc.gov/opportunity/meb_study/auction_utilization_study.pdf).

³² William D. Bradford, Discrimination in Capital Markets, Broadcast/Wireless Spectrum Service Providers and Auction Outcomes 27 (Dec. 5, 2000) (available at www.fcc.gov/opportunity/meb_study/capital_market_study.pdf).

³³ See Ivy Planning Group LLC, Whose Spectrum is it Anyway? Historical Study of Market Entry Barriers, Discrimination and Changes in Broadcast and Wireless Licensing 2, 17, 126 (Dec. 2000) (available at www.fcc.gov/opportunity/meb_study/historical_study.pdf).

³⁴ See, e.g., Part I Fifth Report and Order, 15 FCC Red at 15322.

an auction with a reduced upfront payment,³⁵ and it no longer sets aside licenses for bidding only by designated entities.³⁶ In addition, though it originally permitted designated entities to enter into management or joint marketing agreements with experienced firms without contravening the attribution thresholds in its entrepreneurs' block rules,³⁷ the Commission *now* treats many management and joint marketing agreements as "attributable" under the controlling interest standard.³⁸ The threat of such attribution effectively places many strategic relationships with existing service providers -- providers that benefit from economies of scale and scope -- outside the reach of new entrants.

Thus, at a time when barriers to entry remain great, the resources meant to help designated entities participate in the provision of spectrum-based services are becoming more scarce. The Commission now typically relies on bidding credits as the principal incentive for designated entity participation in competitive bidding. As it reported to Congress last month, "[t]he Commission intends these bidding credits to encourage participation in the competitive

³⁵ See, e.g., Amendment of Parts 20 and 24 of the Commission's Rules -- Broadband PCS Competitive Bidding and the Commercial Mobile Radio Service Spectrum Cap, Report and Order, 11 FCC Red 7824, 7859-60 (1996) (C1, Competitive Bidding Fifth Report and Order, 9 FCC Red at 5600).

³⁶ See, e.g., Service Rules for Advanced Wireless Services in the 1.7 GHz and 2.1 GHz Bands, Report and Order, FCC 03-251, ¶ 68 (rel. Nov. 25, 2003) (resolving not to set aside any advanced wireless services licenses for bidding only by designated entities).

³⁷ See CMRS Fourth Report and Order, 9 FCC Red at 7124 ("We expect that investor-manager agreements are one of the many alternatives available to designated entities. This does not mean, however, that these management agreements will be deemed 'attributable' for purposes of the revenue thresholds in the entrepreneur's blocks"); Competitive Bidding Fifth Report and Order, 9 FCC Red at 5601 n.135 ("So long as the applicant remains under the *de jure* and *de facto* control of the control group, we shall not bar passive investors from entering into management agreements with applicants.")

³⁸ See 47 C.F.R. § 1.2110(c)(2)(i)(11)-(1) (2004).

bidding process by entities that otherwise might have difficulty gaining access to capital.”³⁹ In the absence of a personal net worth limitation, however, wealthy individuals with no difficulty gaining access to capital also qualify for this preference. Against the background of the congressional response to abuses in the tax certificate program, the Commission must remedy this situation without delay. Establishing and enforcing a meaningful personal net worth limitation for competitive bidding small business preference eligibility will help to preserve the designated entity program for the benefit of those that legitimately deserve government assistance.

III. THE COMMISSION’S PERSONAL NET WORTH LIMITATION SHOULD TRACK THE TEST USED FOR THE SBA’S SMALL DISADVANTAGED BUSINESS PROGRAM

To establish a meaningful personal net worth limitation for competitive bidding small business preference eligibility, the Commission should look to the SBA’s small disadvantaged business program.⁴⁰ A concern is not eligible for the benefits of the SBA’s program if, *inter alia*, any attributable investor in the applicant has personal net worth valued at \$750,000 or more.⁴¹ In calculating that personal net worth, the SBA excludes the value of the investor’s ownership interest in the applicant and the value of the investor’s equity in his or her primary personal

³⁹ Section 257 Technical Report to Congress, Identifying and Eliminating Market Entry Barriers for Entrepreneurs and Other Small Businesses, Report, FCC 03-335, ¶ 161 (Feb. 12, 2004) (footnote omitted).

⁴⁰ See id. at ¶ 134 (“Federal departments and agencies that promulgate regulations that affect small businesses usually use the SBA’s size criteria as they develop the regulations.”) (footnote omitted).

⁴¹ See 13 C.F.R. § 124.1002(c) (2004).

residence¹² (Under the SBA's rules, the attributable investor or investors must unconditionally own 51 percent or more of the applicant to qualify for the program¹³)

Council Tree urges the Commission to utilize this SBA personal net worth limitation for competitive bidding small business preference eligibility. Specifically, in addition to applying such other limitations as it uses to establish small business preference eligibility (*e.g.*, gross revenues tests), the Commission should provide that no competitive bidding preference (*e.g.*, bidding credits, installment payment financing, eligibility to bid for a set aside license) made available based on business size shall be awarded to an applicant if the personal net worth of any attributable individual investor in the applicant equals \$750,000 or more at the time the applicant's short-form application is filed.

To address the problem described in this petition, this limitation should be applied only to an individual with both a controlling interest in the applicant under the Commission's Rules *and* an appreciable equity interest in the applicant (directly or indirectly). The second condition is important because the Commission's attribution rules provide that the officers and directors of an applicant, and the officers and directors of an entity that controls the applicant, shall be "considered" to have a controlling interest in the applicant.¹⁴ Unless it limits application of the personal net worth test to an individual with an appreciable equity interest in the venture, the Commission would risk excluding legitimate designated entities from preference eligibility due solely to the net worth of an officer or director without actual control. As many officers or

¹² See id., § 124.104(c)(2).

¹³ See id., § 124.1002(b)(2).

¹⁴ See 47 C.F.R. § 1.2110(c)(2)(iii)(F).

directors will purchase shares in their companies without any incident of control, the triggering equity interest level for application of the personal net worth limitation must also be sufficiently high to avoid implicating an officer or director with equity holdings that are *de minimis*.

On the other hand, because the Commission does not have a minimum equity requirement for actual control under the controlling interest standard, the triggering equity interest level must account for the possibility that a high net worth individual could have *de pure* and *de facto* control of the applicant without retaining much of an equity stake. Setting the triggering interest level at 1 percent of the equity of the applicant—whether in the form of corporate stock, partnership interests, or LLC member interests—should balance these competing interests. (To ensure that its attribution rules do not unfairly “magnify” the size of an officer’s or director’s equity stake for these purposes, the Commission must also provide that Section 1.2110(c)(2)(i)(G) of its rules shall not be applied as part of this calculation to the extent it requires treatment of any link that represents actual control in an ownership chain as if it were a 100 percent interest.)

Finally, attributable individual investors should include individuals who are affiliates⁴⁵ of a controlling interest holder with an appreciable equity stake. The financial condition of affiliates of controlling interests are generally attributed to applicants under the Commission’s rules,⁴⁶ and including individuals who are affiliates of a controlling interest holder with an appreciable equity stake within the scope of the limitation here will help to prevent high net

⁴⁵ See 47 C.F.R. § 1.2110(c)(5) (2004).

⁴⁶ See *id.*, § 1.2110(b)(1)(i)-(ii).

worth individuals from avoiding disqualification under the rule by, *inter alia*, transferring assets among family members.

To calculate “personal net worth,” the Commission may rely on its own earlier definition of the term. The Commission created personal net worth limitations in 1994 as part of its original broadband PCS rules, where it defined personal net worth to mean:

the market value of all assets (real and personal, tangible and intangible) owned by an individual, less all liabilities (including personal guarantees) owed by the individual in his or her individual capacity or as a joint obligor.⁴⁷

In performing the corresponding calculation today, the SBA excludes the value of the individual investor’s ownership interest in the applicant and the value of the individual investor’s equity in his or her primary personal residence.⁴⁸ Should the Commission employ here the definition of personal net worth set forth in its original broadband PCS rules, it should also apply the SBA’s current exclusions to ensure consistency with that agency’s approach.⁴⁹

Thus, for the purposes of this personal net worth limitation, an attributable individual investor should be any individual who (a) is the applicant, (b) has a controlling interest in and directly or indirectly holds 1 percent or more of the equity of the applicant, or (c) is an affiliate of the persons just described. Officers and directors with no meaningful equity stake in the applicant will not be affected. Similarly, wealthy individuals without a controlling interest in the applicant will still be free to invest. It will be wealthy individuals masquerading as designated

⁴⁷ See Competitive Bidding Fifth Report and Order, 9 FCC Red at 5647 (setting forth text of newly-promulgated Section 24.720(h)).

⁴⁸ See 13 C.F.R. §§ 124.104(c)(2), 124.1002(c).

⁴⁹ See 15 U.S.C. § 632(a)(2)(C)(iii) (2004) (providing that no federal agency may prescribe a small business size standard that is not approved by the SBA administrator).

entities who will — and should --- be denied government assistance. Establishing and enforcing this rule will help to ensure that the benefits to be offered in the competitive bidding process will be reserved for those that need government assistance to participate in the provision of spectrum-based services. It will also help to preserve the designated entity program by adhering strictly to the intent of Congress, not promoting the interests of “deep pockets ”

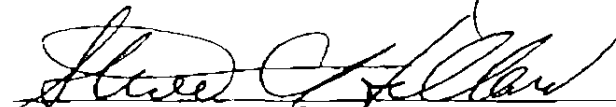
IV. CONCLUSION

For these reasons, Council Tree urges the Commission to amend Part 1 of its Rules, as set forth in ATTACHMENT 1 hereto, to include a personal net worth limitation for competitive bidding small business preference eligibility

Respectfully submitted,

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By:



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TEXT OF PROPOSED RULES

Part 1 of Title 47 of the Code of Federal Regulations is revised as follows:

1. Amend § 1.2110 by inserting “personal” before “net” in paragraph (c)(5)(iii)(A) and by adding new paragraphs (b)(1)(iii) and (p) and revising paragraphs (b)(3)(ii) and (c)(2)(ii)(1) to read as follows:

§ 1.2110 Designated entities.

* * * * *

(b) * * *

(1) * * *

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(iii) The personal net worth of the attributable individual investors in the applicant, as provided in paragraph (p), shall be considered on a non-cumulative basis for purposes of determining whether the applicant (or licensee) is eligible for status as a small business, very small business, or entrepreneur, as those terms are defined in the service-specific rules. An applicant seeking status as a small business, very small business, or entrepreneur, as those terms are defined in the service-specific rules, must disclose on its short- and long-form applications the personal net worth of each attributable individual investor in the applicant at the time the applicant’s short-form application (Form 175) is filed.

* * * * *

(3) * * *

* * * * *

(ii) Applicants without identifiable controlling interests. Where an applicant (or licensee) cannot identify controlling interests under the standards set forth in this section, (A) the gross revenues of all interest holders in the applicant, and their affiliates, will be attributable; and (B) the personal net worth of all individuals that hold interests in the applicant, and their affiliates, will be considered for the purposes of paragraph (p).

(c) * * *

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(2) * * *

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(ii) * * * *

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- (i) Officers and directors of the applicant shall be considered to have a controlling interest in the applicant. The officers and directors of an entity that controls a licensee or applicant shall be considered to have a controlling interest in the licensee or applicant. Except as provided in paragraph (p), the personal net worth, including personal income of the officers and directors of an applicant, is not attributed to the applicant. To the extent that the officers and directors of an applicant are affiliates of other entities, the gross revenues of the other entities are attributed to the applicant.

* * ~ * *

(p) *Personal Net Worth*

- (1) No competitive bidding preference based on business size shall be awarded to an applicant (or licensee) if the personal net worth of any attributable individual investor in the applicant equals \$750,000 or more at the time the applicant's short-form application (Form 175) is filed.
- (2) Personal net worth shall mean the market value of all assets, real and personal, tangible and intangible, owned by an individual, excluding the individual's ownership interest in the applicant and the equity in the individual's primary personal residence, less all liabilities, including personal guarantees, owed by the individual in his or her individual capacity or as a joint obligor.
- (3) An attributable individual investor is any individual who
- (i) is the applicant, or
 - (ii) (A) has a controlling interest in the applicant, and
(B) directly or indirectly holds 1 percent or more of the equity (whether in the form of stock, partnership interests, or member interests) of the applicant, or
 - (iii) is an affiliate of an individual described in paragraphs (p)(3)(i) or (ii).
- (4) For the purposes of calculating the equity holdings of a controlling interest individual under paragraph (p)(3)(ii)(B), § 1-2110(c)(2)(ii)(G) shall not be applied.

to the extent it requires treatment of any link that represents actual control in an ownership chain as if it were a 100 percent interest

- (5) As part of the applicant's (or licensee's) short- and long-form applications, each attributable individual investor in the applicant shall certify that the personal net worth listed for that individual is accurate

- 2 Amend § 1.2112 by removing "and" after the semicolon in paragraph (b)(1)(ii), by redesignating paragraph (b)(1)(iii) as (b)(1)(iv), by redesignating paragraphs (b)(2)(v) and (b)(2)(vi) as (b)(2)(vi) and (b)(2)(vii), and by adding new paragraphs (b)(1)(iii) and (b)(2)(v) to read as follows

§ 1.2112 Ownership disclosure requirements for applications.

* * * * *

(b) * * *

* * * * *

(1) ~ * *

* * * * *

- (iii) List separately the personal net worth, computed in accordance with § 1.2110, of each attributable individual investor in the applicant, and

* * * * *

(2) * * *

* * * * *

- (v) List separately the personal net worth, computed in accordance with § 1.2110, of each attributable individual investor in the applicant,

* * * * *